Report

of the

Examination of

Old Republic Surety Company

Brookfield, Wisconsin

As of December 31, 2002

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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Jorge Gomez, *Commissioner*

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October 30, 2003

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Commissioner:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

OLD REPUBLIC SURETY COMPANY
BROOKFIELD, WISCONSIN

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of Old Republic Surety Company (hereinafter, also "ORSC" or "the company") was conducted in 1998 as of December 31, 1997. The current examination covered the intervening period ending December 31, 2002, and included a review of such 2003 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

History
Management and Control
Corporate Records
Conflict of Interest
Fidelity Bonds and Other Insurance
Employees' Welfare and Pension Plans
Territory and Plan of Operations
Affiliated Companies
Growth of Company
Reinsurance
Financial Statements
Accounts and Records
Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

Independent Actuary's Review

Independent actuaries were engaged under a contract with the Office of the Commissioner of Insurance (OCI). They reviewed the adequacy of the company's loss reserves and loss adjustment expense reserves. The results of their work were reported to the examiner-in-charge. As deemed appropriate, reference is made in this report to the actuaries' conclusion.

II. HISTORY AND PLAN OF OPERATION

Old Republic Surety Company was incorporated on December 28, 1981, under the title, “Northwestern National Surety Company”, and commenced business on the same date. The company was organized as a subsidiary of Northwestern National Insurance Company of Milwaukee, Wisconsin (hereinafter also, “NNIC”) to specialize in underwriting surety and fidelity risks.

Northwestern National Insurance Company of Milwaukee, Wisconsin, a subsidiary of Armco Inc., is a multi-line P&C insurer and reinsurer. Prior to the organization of the company, NNIC had acquired Lawyers Surety Corporation (hereinafter also, “LSC”) and State Surety Company (hereinafter also, “SSC”), and assumed their business. In 1982, the company began to assume the surety and fidelity risks of NNIC. In 1983, NNIC contributed the stock of LSC and SSC to the company.

During NNIC’s ownership, the company acted as a reinsurer as well as a direct writer. NNIC reinsured 100% of the direct business of LSC and SSC, and ceded its direct fidelity and surety risks, together with the business assumed from LSC and SSC, to the company. Agents of LSC and SSC wrote business where these insurers were licensed, while NNIC’s agents wrote in the other states. LSC and SSC functioned as the company’s marketing vehicles and branch offices.

On May 30, 1986, Northwestern National Insurance Company of Milwaukee, Wisconsin, sold the company and its subsidiaries to Old Republic International Corporation (hereinafter also, “ORI”). ORI contributed the shares to Old Republic General Insurance Group, Inc., which, in turn, contributed the shares to Old Republic Surety Group, Inc. In this manner, ORSC became a third-tier subsidiary of ORI, and a direct, wholly owned subsidiary of Old Republic Surety Group, Inc. Effective with the acquisition, the company’s name was changed to that presently used.

Effective November 15, 1991, ORSC entered into transfer and assumption contracts with LSC and SSC, rendering these companies inactive except with respect to bonds of definite expiry for which premiums had already been collected. The licenses and charters of Lawyers

Surety Corporation and State Surety Company were sold to nonaffiliated organizations on June 2, 1994, and February 1, 1995, respectively.

The company is staffed by its own officers and employees, and pays most of its expenses on its own behalf. However, as a member of a holding company system, ORSC engages in the exchange of risks and services with affiliates under various written agreements. Accordingly, intercompany balances are created in the ordinary course of business with settlements made on either a monthly or quarterly basis, depending on the terms of the applicable written agreement. Expenses other than taxes are allocated on the basis of specific identification or resource utilization estimates. The company files its federal income taxes on a consolidated basis with Old Republic International Corporation and other affiliates that are regarded as being members of ORI's General Insurance Group.

The company leases all office and warehouse facilities necessary to its operations. ORSC's operations are coordinated from its home office in Brookfield, Wisconsin. A warehouse in New Berlin, Wisconsin, is leased for the storage of home office records. Support services are provided through a network of satellite office facilities in the following 14 cities:

Atlanta, Georgia	Des Moines, Iowa	Phoenix, Arizona
Baltimore, Maryland	Irving, Texas	Pittsburgh, Pennsylvania
Chicago, Illinois	Los Angeles, California	Portland, Oregon
Columbus, Ohio	Milwaukee, Wisconsin	Salt Lake City, Utah
Dallas, Texas	Orlando, Florida	

The company writes direct premium in the following states:

Illinois	$ 2,694,959	10.7%
Florida	2,308,470	9.1
Texas	1,878,729	7.4
Minnesota	1,628,106	6.4
Oregon	1,072,293	4.3
All others	15,683,457	62.1
Total	$ 25,266,014	100.0%

The company is licensed in the District of Columbia and all states except Alaska, Connecticut, Delaware, Hawaii, Kentucky, Louisiana, Maine, Massachusetts, Michigan, New Hampshire, New Jersey, New York, Rhode Island, and Vermont.

In the state of Wisconsin, the company is licensed to transact the following lines of business as defined by s. Ins 6.75(2), Wis. Adm. Code:

(d) Liability and Incidental Medical Expense
(f) Fidelity
(g) Surety
(n) Miscellaneous

All direct business is written through independent agents, numbering 8,711 at the time of this examination. The company uses standard contract forms and commission schedules for its agents. Agents are compensated according to the following commission schedule:

Product Type	**Commission Rate**
Blanket fidelity bonds, including public employees' blanket bonds and forgery coverage	20%
Contract bonds (only on first $2,500,000 of contract price, with no commission on the portion above that amount)	25
Any bonds involving abnormal acquisition costs or other expense or unusual hazards or exposures	Negotiated
All other product types	30

In addition, agents are eligible to receive a contingent commission, which is multiplied by the premiums earned by the company from that agent's production. Agents earn contingent commission of 1% to 6% of the premiums earned. The sliding scale for contingent commissions is based on the agent's composite ratio, which the company defines as the sum of (a) the ratio of incurred losses to earned premiums and (b) the ratio of commissions to written premium. The lower an agent's composite ratio, the higher the agent's contingent commission rate. No contingent commission is paid if the agent's composite ratio is 55% or higher. Exceptionally favorable or unfavorable experience is carried forward, but only to the first succeeding year.

In addition to its direct business, the company reinsures the surety and fidelity risks of affiliates, Old Republic Insurance Company (hereinafter also "ORIC") and Bituminous Casualty Company. The company underwrites and coordinates the marketing of surety and fidelity bonds on behalf of these affiliates, which write such risks mainly in jurisdictions in which ORSC is not licensed. A small block of business has also been developed through another ORI affiliate, International Business and Mercantile Reassurance Company (hereinafter also, "IB&M RE"). This business is ceded to ORIC, which then cedes this business, together with its own fidelity and surety risks, to ORSC.

The following table is a summary of the net insurance premiums written by the company in 2002. The growth of the company is discussed in the Financial Data section of this report.

Line of Business	Direct Premium	Reinsurance Assumed	Reinsurance Ceded	Net Premium
Other liability - occurrence	$ 58,474	$ 40,998	$	$ 99,472
Fidelity	4,251,500	490,343	211,012	4,530,831
Surety	20,956,040	7,620,041	1,250,263	27,325,818
Total All Lines	$25,266,014	$8,151,382	$1,461,275	$31,956,121

The following table is a summary of the direct and assumed insurance premiums written by specific product lines offered by the company in 2002.

Line of Business	Gross Premium	Percent of Product Mix
Other Liability:		
Notary errors and omissions	$ 99,472	0.3%
Fidelity:		
Business services	1,514,263	4.5
ERISA/Pension	977,616	2.9
Miscellaneous fidelity	2,249,964	6.7
Fidelity subtotal	4,741,843	14.2
Surety:		
Contract	10,449,019	31.3
Other judicial bonds	500,410	1.5
Fuel tax	252,302	0.8
Motor vehicle dealers	2,624,346	7.9
Contractors license	5,814,015	17.4
All other license and permit	4,270,353	12.8
Miscellaneous indemnity	1,388,162	4.2
Public official	1,058,809	3.2
Notary	1,124,120	3.4
Surety subtotal	27,481,536	82.2
Discontinued Lines:		
Probate	1,094,545	3.3
Total All Lines	$33,417,396	100%

III. MANAGEMENT AND CONTROL

Control by Succession of Parent Corporations

Old Republic International Corporation holds ultimate control of the company's board and of its executive direction. As more thoroughly described both previously and in Section IV, "Affiliated Companies," of this report, ORI indirectly owns 100% of the issued and outstanding common shares of the company. Accordingly, ORI effectively controls the nomination and election of the board of directors.

Board of Directors

The board of directors consists of three members. Directors are elected annually to serve one-year terms. The directors, as executive employees of the holding company system, receive no compensation specific to their service on the board. Members of the company's board of directors may also serve as members of other boards of directors in the holding company system. Officers are elected at the board's annual organizational meeting, and as positions are created or fall vacant.

Currently, the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
James E. Lee Brookfield, Wisconsin	President and Chief Executive Officer Old Republic Surety Company	2003
David G. Menzel Cedarburg, Wisconsin	Senior Vice President and Chief Financial Officer Old Republic Surety Company	2003
Aldo C. Zucaro Barrington, Illinois	Chairman of the Board and Chief Executive Officer Old Republic International Corporation	2003

Officers of the Company

The officers serving at the time of this examination are as follows:

Name	Office	2002 Compensation
Aldo C. Zucaro	Chairman of the Board and Treasurer	$ #
James E. Lee	President and Chief Executive Officer	297,974
Spencer A. LeRoy, III	Secretary	*
Michael A. Jankowski	Senior Vice President	147,777
David G. Menzel	Senior Vice President, Assistant Treasurer and Assistant Secretary	164,248

This figure does not include compensation paid to Mr. Zucaro by other companies within the holding company system. The notice to the shareholders of Old Republic International Corporation of the annual meeting held on May 23, 2003, indicated that the salary, bonus, and other compensation paid to Mr. Zucaro in 2002 amounted to $1,301,425.

* This figure does not include compensation paid to Mr. LeRoy, III by other companies within the holding company system. The notice to the shareholders of Old Republic International Corporation of the annual meeting held on May 23, 2003, indicated that the salary, bonus, and other compensation paid to Mr. LeRoy, III in 2002 amounted to $586,470.

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Executive Committee
Aldo C. Zucaro, Chair
James E. Lee
David G. Menzel

Finance Committee
Aldo C. Zucaro, Chair
James E. Lee
David G. Menzel

Compensation Committee
Aldo C. Zucaro, Chair
James E. Lee
David G. Menzel

IV. AFFILIATED COMPANIES

Old Republic Surety Company is a member of a holding company system led by Old Republic International Corporation (hereinafter also, “Old Republic holding company system”). The organizational chart below depicts the relationships among the affiliates in the group. The organizational chart follows a brief description of the holding company structure and significant affiliates as well as its subsidiary.

Old Republic International Corporation is one of the 50 largest publicly held insurance organizations in the United States, with a substantial interest in a diversified range of insurance and reinsurance services. ORI holds direct or indirect ownership or majority control over 94 corporations, excluding inactive or otherwise financially insignificant entities. The holding company system does not conduct significant operations outside of the United States and Canada. While various offshore entities belong to the Old Republic holding company system, such corporations exist to facilitate the management of U.S. and Canadian based risks. The entire emphasis of the Old Republic holding company system is on insurance and activities incidental to or in support of the distribution of insurance.

The Old Republic holding company system conducts its operations through four operational groups, consisting of the General Insurance Group, the Mortgage Insurance Group, the Title Insurance Group, and the Life Insurance Group. The General Insurance Group provides commercial lines of property and liability insurance and reinsurance, predominantly to industrial, mining, transportation, and financial services companies, as well as actuarial consulting, tax planning, claims control, and management of captive or retrospectively rated insurance programs. The Mortgage Insurance Group provides residential mortgage guaranty insurance for first mortgage loans to mortgage bankers, commercial banks, thrifts, credit unions, and other financial institutions. The Title Insurance Group provides title insurance and related real estate transfer services for individuals, businesses, and government entities. The primary emphases of the Life Insurance Group are on marketing credit life and disability insurance products through automobile dealers, and providing large-face-amount term life insurance products through a network of independent life brokerage general agencies. They also sell specialty life and health products through lenders, travel agents and educational institutions.

Within these four broad segments, ORI and its subsidiaries have sought to act as a niche player specializing in a relatively limited number of industries or lines of insurance. Growth has been sought through methodical progress within the specific industries and product niches to which the Old Republic holding company system has committed itself.

ORSC may be regarded as a member of a distinct holding company subsystem within the General Insurance Group, consisting of Old Republic Surety Group, Inc., ORSC, Old Republic Surety Consulting, Inc., and Capital Services Agency. These entities serve the small to mid-sized surety market segment. ORSC writes or reinsures nearly all of the surety business written by the members of the Old Republic holding company system.

Present Succession of Control

Old Republic International Corporation

Old Republic International Corporation is a Chicago-based multiple lines insurance holding company incorporated under the laws of Delaware on March 10, 1969. ORI's common shares are publicly traded on the New York Stock Exchange. One outstanding class of preferred stock, the Series G Convertible Preferred, exists to support the corporation's employee stock option plan and does not trade, though it is convertible into common shares under certain restrictive terms and conditions. On a consolidated basis for the fiscal year ending December 31, 2002, ORI reported assets of $8,715,400,000, liabilities and preferred stock of $5,559,500,000, total common shareholders' equity of $3,155,800,000, total revenues of $2,756,400,000, and a net income of $392,900,000.00.

Old Republic General Insurance Group, Inc.

Old Republic General Insurance Group, Inc. (hereinafter also "ORGIG"), was incorporated in Delaware on December 3, 1979. This wholly owned subsidiary of ORI is the leading holding company of ORI's General Insurance Group, exercising direct or indirect ownership or effective control over 35 corporations, excluding inactive or otherwise financially insignificant entities. The General Insurance Group is the most significant operating division within the Old Republic holding company system and contains the greatest diversity in terms of the lines of business written and scope of ancillary insurance activities. ORGIG's consolidated statutory financial statement as of December 31, 2002, reported assets of $4,021,564,588, liabilities of $2,743,505,059, common shareholder's equity of $1,278,059,528, and net income of $112,295,283.00.

Old Republic Surety Group, Inc.

Old Republic Surety Group, Inc. (hereinafter also "ORS Group"), organized on March 27, 1986, is a holding company domiciled in Delaware. The corporation was organized as a means to reward executives responsible for the financial results of ORSC and its subsidiaries should their guidance in the initial years of these companies profit ORI. ORGIG provided $13,400,000 of the corporation's initial capitalization through the purchase of 4,000 common shares at $100 per share, 9,500 shares of redeemable voting preferred shares at $1,000 per share, and $3,500,000 in ten-year debentures. Seven executives subscribed to a total of 1,000 common shares at $100 per share. Pursuant to a stock subscription and purchase agreement dated effective May 30, 1986, participating executives were able to exchange their common shares for cash or common shares of ORI between July 1, 1996, and July 1, 2001. All the executives have exchanged their common shares resulting in ORGIG owning 100% of the ORS Group. On a consolidated basis, as of December 31, 2002, ORS Group reported assets of $98,716,811, liabilities of $51,435,641, common shareholder's equity of $47,281,170, and net income of $5,240,979.00.

Significant Affiliates

This section addresses affiliated entities that are not in the "succession of control" section above, but with which the company has some business relationship.

Old Republic Asset Management Corporation

Old Republic Asset Management Corporation (hereinafter also "ORAM"), organized as an Illinois corporation on January 28, 1966, provides investment management services to the members of the Old Republic holding company system, including ORSC, pursuant to written agreements. The corporation was initially known as Trinity Insurance Agency, Inc. In March 1980, the corporate title was changed to that presently used as a reflection of the change in its purpose and scope of activities. The corporation has no employees; rather it utilizes those of ORIC. Functionally, it serves as a cost allocation center for accounting control purposes. ORAM is a wholly owned second-tier subsidiary of ORI. As of December 31, 2002, the corporation reported assets of $363,924, liabilities of $78,687, common shareholder's equity of $363,924, total revenues of $1,667,704, and net income of $236,363.00.

Old Republic General Services, Inc.

Old Republic General Services, Inc., organized as an Illinois corporation on July 20, 1960, provides various general and administrative services for members of the Old Republic holding company system, including ORSC. Services include, but are not limited to, accounting, records management, tax preparation, legal activity, and data processing. Services of this type are provided pursuant to written service agreements. The corporation has no employees of its own rather it utilizes those of ORIC. Functionally, it serves the same purpose as ORAM, except for different categories of expense. The corporation was formerly known as R. E. Flannery & Associates, Inc. In 1978, the corporate title was changed to that presently used as a reflection of the change in its purpose and scope of activities. Old Republic General Services, Inc., is a wholly owned second-tier subsidiary of ORI. As of December 31, 2002, the corporation reported assets of $4,200,950, liabilities of $4,219,815, common shareholder's equity of ($18,865) total revenues of $9,815,854, and net income of $92,918.00.

Old Republic Insurance Company

Old Republic Insurance Company was incorporated under the laws of the Commonwealth of Pennsylvania on April 11, 1935, and commenced business on April 21, 1935. Interests identified with various coal companies and allied industrial concerns organized the corporation under the title, "Coal Operators Casualty Company." On April 18, 1955, the Old Republic holding company system acquired control of the corporation from its original sponsors, and on June 7 of the same year, changed the name to that presently used.

ORIC is the lead carrier and primary employer in ORI's General Insurance Group. ORIC's marketing efforts are concentrated on large commercial accounts with specialized insurance requirements. It is licensed in all 50 U.S. states, the District of Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands. On its 2002 statutory annual statement, ORIC reported net admitted assets of $1,589,636,000, liabilities of $1,053,198,000, policyholders' surplus of $536,439,000, and net income of $44,402,000.00.

Old Republic Surety Consulting, Inc.

Old Republic Surety Consulting, Inc., was incorporated in Delaware on May 27, 1992. This wholly owned subsidiary of ORS Group was organized to provide consulting services on surety issues to nonaffiliated parties from time-to-time. The corporation has no employees of its own, but rather utilizes employees of ORSC as necessary. Functionally, it serves as a cost allocation center for accounting control purposes. As of December 31, 2002, the corporation reported assets of $185,972, liabilities of $90, shareholder's equity of $185,872, and net income of $1,002.00.

Subsidiary

Capital Services Agency, Inc.

Capital Services Agency, Inc. (hereinafter also, "CSA"), was incorporated in Iowa on September 1, 1963. Old Republic Surety Company acquired the corporation in connection with its acquisition of State Surety Corporation on December 31, 1982. CSA is an insurance agency that specializes in the placement of surety risks with its parent, ORSC, and affiliate ORIC. As of December 31, 2002, CSA reported assets of $193,254, liabilities of $60,740, common shareholder's equity of $132,514, and a net income of $35,489.00.

Organizational Chart
As of December 31, 2002

Old Republic International Corporation (DE)	"ORI"
Old Republic General Insurance Group, Inc. (DE)	"ORGIG"
Bitco Corporation. (DE)	
Bituminous Casualty Corporation (IL)	
International Business & Mercantile Reassurance Co. (IL)	"IB&M RE"
Old Republic Insurance Company (PA)	"ORIC"
Old Republic Surety Group, Inc. (DE)	"ORS Group"
Old Republic Surety Company (WI)	"ORSC"
Capital Service Agency, Inc. (IA)	"CSA"
Old Republic Surety Consulting, Inc. (DE)	
Old Republic Asset Management Corporation (IL)	"ORAM"
Old Republic Marketing, Inc. (IL)	
Old Republic General Services, Inc. (IL)	

Note that the above organizational chart is a modification of the original due to the complexity of the groups's structure. The examiner included only affiliates that directly effect the operations of Old Republic Surety Company. The acronym used in this report is also shown.

Agreements with Affiliates

The company is staffed by its own officers and employees, and pays most of its expenses on its own behalf. However, as a member of a holding company system, ORSC engages in the exchange of risks and services with affiliates under various written agreements. Reinsurance agreements are described in the reinsurance section of this report. A brief summary of the other ten agreements follows, with the arrangement in chronological order.

Tax Sharing Agreement

ORSC became party to a federal income tax-sharing agreement by and between ORI and its General Insurance Group subsidiaries through an addendum to this agreement dated June 1, 1986. This agreement neutralizes any advantage or disadvantage as a result of the consolidation of federal income taxes. If any party's federal income tax liability, as computed on a separate return basis without regard to consolidation, is less than its allocated share under consolidation, ORI is to reimburse that party for the deficiency. If any party's federal income tax liability, as computed on a separate return basis without regard to consolidation, is greater than its allocated share under consolidation that party is to reimburse ORI in an amount equal to the gain. ORI is obligated to render statements for settlement under this agreement within 30 days after the applicable federal income tax filing. Unless the subsidiary objects, settlement is to occur within 15 days of receipt of the statement. This agreement may be cancelled at the end of any taxable year with 30 days' advance written notice.

Service Agreement

Effective June 1, 1986, the company entered into a service agreement whereby the company is to provide certain services with respect to the fidelity and surety business produced by ORIC, including, but not limited to, underwriting, claims management, billing and receipts, rate and form filings, appointment, training, supervision of agents, and accounting services. Any party may terminate this agreement at any time with 120 days' prior written notice. The agreement would terminate automatically upon termination of reinsurance cessions to ORSC.

Expense Reimbursement Agreement

Effective June 1, 1986, the company entered into an expense reimbursement agreement with ORIC. Under this agreement, the company agrees to furnish ORIC with a quarterly statement of expenses incurred with respect to its service agreement effective June 1, 1986, as described in the foregoing paragraph. Invoiced expenses may include allocations of salaries and other overhead items, but shall not in any case exceed on an annual basis 30% of the total premiums covered by its reinsurance agreement effective June 1, 1986 (treaty #3 in the "Reinsurance" section of this report). ORIC has the right to inspect relevant books and records of ORSC at any time during normal business hours. Any dispute that cannot be agreeably resolved between the parties is to be referred to the internal auditors of ORI for resolution. Each party may set off any obligation or right under this agreement against any right or obligation against this or any other agreement or transaction between the parties. There is no direct provision for termination, but as a practical matter, cancellation and runoff of the company's assumption reinsurance contract with ORIC would effectively nullify this agreement, as would cancellation of the service agreement effective June 1, 1986.

Service Agreement with Old Republic Surety Consulting, Inc.

Effective January 1, 1992, the company entered into an agreement with Old Republic Surety Consulting, Inc., whereby the company would make officers and employees available to Old Republic Surety Consulting, Inc., as necessary. Old Republic Surety Consulting, Inc., in turn, agrees to furnish ORSC with evidence of its authority to perform services as required on its behalf and to reimburse ORSC for funds advanced and expenses incurred on its behalf. Either party may terminate this agreement at any time with 120 days' written notice to the other.

Expense Reimbursement Agreement with Old Republic Surety Consulting, Inc.

Effective January 1, 1992, the company entered into an expense reimbursement agreement with Old Republic Surety Consulting, Inc. Under this agreement, the company agrees to furnish Old Republic Surety Consulting, Inc., with a quarterly statement of expenses incurred with respect to its service agreement effective January 1, 1992, as described in the foregoing paragraph. Invoiced expenses may include costs incurred in performing accounting and administrative services and may include allocations of salaries and other overhead items. Old Republic Surety Consulting, Inc., has the right to inspect relevant books and records of ORSC at any time during normal business hours. Any dispute that cannot be agreeably resolved between the parties is to be referred to the internal auditors of ORI for resolution. Each party may set off any obligation or right under this agreement against any right or obligation against this or any other agreement or transaction between the parties. Either party may terminate this agreement at any time with 120 days' written notice to the other. This agreement was amended effective January 1, 1994, to clarify wording with respect to services provided by ORSC.

Service Agreement with Old Republic Insurance Company

Effective January 1, 1994, the company entered into an agreement with ORIC, whereby each party agreed to avail itself of certain resources and support to be provided by the other. ORSC agreed to provide ORIC with human resources support, administration of the executive fleet program, and payroll functions. Though not specified in the agreement, ORSC's services with respect to this agreement apply only to employees of ORIC's Milwaukee branch. ORIC agreed to furnish ORSC with data processing hardware and related software, lease management for its home office only, and mail room services. Either party may terminate this agreement at any time with 120 days' written notice to the other. In the event of termination, both parties will provide reasonable assistance to the other in obtaining replacement services. This agreement is separate and distinct from the service agreement between the parties effective June 1, 1986.

Expense Reimbursement Agreement with Old Republic Insurance Company

Effective January 1, 1994, the company entered into an expense reimbursement agreement with ORIC. Under this agreement, the parties agree to furnish one another with monthly statements of expenses incurred with respect to their service agreement effective January 1, 1994, as described in the foregoing paragraph.

ORSC is to furnish a monthly billing reflecting service rendered based on the following:

A. Human resources charges on the proportionate share of employees multiplied by human resource salaries and associated costs.

B. Cost of leases for fleet automobiles on actual billings as received by the leasing company.

C. Health insurance on an actual basis for participation under the health insurance plan in force.

ORIC is to furnish a monthly billing reflecting service rendered based on the following:

A. The central processing unit (CPU) utilization factor is to be negotiated annually based on current and expected activity.

B. Disk space on actual storage in megabytes multiplied by the cost per megabyte.

C. Data processing operation overhead is to be based on the CPU utilization factor.

D. IBM and other software on the CPU utilization factor.

E. Occupancy cost is to be apportioned on actual square footage utilized.

F. Mail room at an hourly rate.

Any costs which are paid by either party to outside concerns which can be directly identified to the other party are to be billed directly on a monthly basis and may be included with the monthly invoices for services rendered. Each party may set off any obligation or right under this agreement against any right or obligation against this or any other agreement or transaction between the parties. Either party may terminate this agreement at any time with 120 days' written notice to the other.

Investment Counsel Agreement with Old Republic Asset Management Corporation

Effective October 1, 1995, the company entered into an investment counsel agreement with ORAM. Under this agreement, ORAM is to act as investment counsel, advising the company on investment policy, executing purchases and sales of investments as instructed by company, monitor the value of its invested assets, and preparing investment statements for insurance regulatory purposes on a quarterly basis. This agreement may be terminated by either party at the end of any quarterly investment period upon 30 days' advance notice. The fee for services provided by ORAM is a sliding scale percentage that declines as assets under management increase. ORSC is to pay ORAM the following quarterly fee based on assets under management (less a working capital credit in the amount of $1,000,000) at the date the fee is assessed. It should be noted that this agreement was amended, effective April 1, 2002, to adjust the fee to what is now being currently charged ORSC.

Net Portfolio Assets	Quarterly Fee	Annualized Quarterly Fee
Minimum Fee	$500	$2,000
First $100,000,000	1.75 basis points	7 basis points
Next $150,000,000	1.25 basis points	5 basis points
Over $250,000,000	0.75 basis points	3 basis points

In 2002, ORSC incurred $52,572 in fees for investment counsel and services rendered by ORAM.

Expense Reimbursement Agreement with Old Republic Surety Group, Inc.

Effective January 1, 1997, the company entered into an expense reimbursement agreement with ORS Group. Under this agreement, the company agrees to furnish ORS Group with a statement in September and December of each year of expenses incurred with respect to any accounting and miscellaneous services that the company might perform for ORS Group. Invoiced expenses may include costs incurred in performing accounting and administrative services and may include allocations of salaries and other overhead items. ORS Group has the right to inspect relevant books and records of ORSC at any time during normal business hours. Any dispute that cannot be agreeably resolved between the parties is to be referred to the internal auditors of ORI for resolution. Each party may set off any obligation or right under this agreement against any right or obligation against this or any other agreement or transaction between the parties. There is no formal provision for the termination of services under this agreement.

Service and Expense Reimbursement Agreement with Capital Service Agency, Inc.

Effective January 1, 1999, the company entered into a service and expense reimbursement agreement with Capital Service Agency, Inc. Under this agreement, the company agrees to furnish CSA with a statement periodically throughout the year of expenses incurred with respect to any accounting and miscellaneous services that the company might perform for CSA. Invoiced expenses may include costs incurred in performing accounting and administrative services and may include allocations of salaries and other overhead items. CSA has the right to inspect relevant books and records of ORSC at any time during normal business hours. Any dispute that cannot be agreeably resolved between the parties is to be referred to the internal auditors of ORI for resolution. Each party may set off any obligation or right under this agreement against any right or obligation against this or any other agreement or transaction between the parties. There is no formal provision for the termination of services under this agreement.

V. REINSURANCE

The company's reinsurance portfolio and strategy is described below. A list of the companies that have a significant amount of reinsurance in force at the time of the examination follows. The contracts contained proper insolvency provisions.

Nonaffiliated Ceding Contracts

1.	Type:	Excess of Loss Surety/Fidelity
	Reinsurers:	American Re-Insurance Company (50%) General Reinsurance Corporation (50%)
	Scope:	Contract surety, miscellaneous surety, fidelity, and forgery bonds. Reinsurance assumed from other insurers and associations, except former members of the Armco Insurance Group or member companies of the Old Republic Group, is excluded.
	Retention:	(1) With respect to contract surety, \$250,000, plus 5% of net loss as regards each principal in excess of \$250,000, up to a per principal limit of \$2,750,000 (2) With respect to miscellaneous surety, \$250,000 each principal up to a per principal limit of \$2,750,000 (3) With respect to fidelity and forgery, \$250,000 each loss event up to a per loss event limit of \$2,750,000
	Coverage:	(1) With respect to contract surety, 95% net retained loss, including loss adjustment expenses, in excess of \$250,000, not to exceed an each principal limit of 95% of \$2,750,000 (2) With respect to miscellaneous surety, 100% of net retained loss of each principal excess of \$250,000, not to exceed an each principal limit of 100% of \$2,750,000 (3) With respect to fidelity and forgery, 100% of the net retained loss excess of \$250,000 not to exceed an each loss event limit of 100% of \$2,750,000 (4) Total coverage for all principals and loss events shall not exceed an annual aggregate limit of \$8,000,000 for each calendar year in which the contract remains in effect
	Premium:	3.7% of gross fidelity and surety premium in the first calendar quarter of the agreement, thereafter adjusted quarterly to range from 1.5% to 7.0% of subject premium, based on quarterly determination of the cumulative layer balance.
	Commissions:	None
	Effective date:	January 1, 2002, as amended

Termination: By either party giving not less than 90 days' notice as of any December 31st. The reinsurers shall not be liable for losses discovered after the effective date of termination unless the company exercises its extended discovery option. Extensions are for one-year periods, to a maximum extension of three years. Should the company choose to exercise its option for extended discovery, coverage is limited to the unexhausted portion remaining at the effective date of termination, if any, of the $8,000,000 annual aggregate limit.

2. Type: Second Surety Excess of Loss

Reinsurers: American Re-Insurance Company (50%)
General Reinsurance Corporation (50%

Scope: Contract surety, miscellaneous surety, fidelity, and forgery bonds. Reinsurance assumed from other insurers and associations, except former members of the Armco Insurance Group or member companies of the Old Republic Group, is excluded.

Retention:
(1) With respect to contract surety, $3,000,000, plus 10% of net loss as regards each principal in excess of $3,000,000, up to a per principal limit of $2,000,000
(2) With respect to miscellaneous surety, $3,000,000, plus 10% of net loss as regards each principal in excess of $3,000,000, up to a per principal limit of $2,000,000
(3) With respect to fidelity and forgery, $3,000,000, plus 10% of net loss as regards each loss event in excess of $3,000,000, up to a per loss event limit of $2,000,000

Coverage:
(1) With respect to contract surety, 90% of net loss as regards each principal in excess of $3,000,000, up to an each principal limit of 90% of $2,000,000
(2) With respect to miscellaneous surety, 90% of net loss regards each principal in excess of $3,000,000, up to an each principal limit of 90% of $2,000,000
(3) With respect to fidelity and forgery, 90% of net loss as regards each loss event in excess of $3,000,000, up to an each loss even limit of 90% of $2,000,000
(4) Total coverage for all principals and loss events shall not exceed an annual aggregate limit of $6,000,000 for each calendar year in which the contract remains in effect

Premium: 0.75% of gross surety and fidelity premiums written, subject to an annual minimum premium of $200,000

Commissions: None

Effective date: January 1, 2002, as amended

Termination:	By either party giving not less than 90 days' notice as of any December 31st. The reinsurers shall not be liable for losses discovered after the effective date of termination unless the reinsurers made termination and the company exercises its one-year extended discovery option. Extensions are for one-year periods, to a maximum extension of three years. Should the company choose to exercise its option for extended discovery, coverage is limited to $6,000,000 in the aggregate.

Affiliated Assuming Contracts

3. Type: 100% Quota Share

Reinsured:	Old Republic Insurance Company
Scope:	Fidelity, surety, and notary public errors and omissions insurance or reinsurance.
Retention:	None
Coverage:	100% of all liability of the reinsured under contracts underwritten and managed for the reinsured through the offices of the reinsurer and produced by agents of the reinsured appointed at the request of the reinsurer.
Premium:	100% of subject premiums, less applicable ceding commission
Commissions:	Ceding commissions vary upon the type of coverage.
Effective date:	June 1, 1986, as last amended on April 1, 1996.
Termination:	At any December 31st by either party providing at least 90 days' prior written notice

4. Type: 100% Quota Share

Reinsured:	Bituminous Casualty Corporation
Scope:	All risks of fidelity and surety risks underwritten by Bituminous Casualty Corporation or its subsidiaries, excluding fidelity on package policies
Coverage:	100% of all fidelity and surety losses, including loss adjustment expenses, incurred by the reinsured or its subsidiaries
Premium:	100% of subject premium
Commissions:	The company agrees to reimburse the reinsured for 100% of all costs incurred by the reinsured for its fidelity and surety department
Effective date:	April 1, 1989
Termination:	At any date by either party giving 60 days' advance written notice

Facultative Contracts

The company conducts facultative cessions with nonaffiliated reinsurers when risks it desires to underwrite exceed treaty limits or have some other unusual characteristic. Under its facultative arrangements, the participating insurers make a joint decision regarding the acceptability of the risk and negotiate their respective participation. Actual cession of risk is accomplished through formal offer and acceptance, whereby the company writes a formal offer to each participant for the cession of agreed upon portions of the risk. The company uses facultative arrangements only occasionally. At the examination date, the company had only three facultative cessions in force on three bonds. Reinsurers included American Re-Insurance Company and General Reinsurance Corporation.

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2002, annual statement. Also included in this section are schedules that reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination."

Old Republic Surety Company
Assets
As of December 31, 2002

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$65,345,781	$	$65,345,781
Stocks:			
Common stocks	4,697,928		4,697,928
Cash			
Short-term investments	2,591,061		2,591,061
Other invested assets	538,974		538,974
Agents' balances or uncollected premiums:			
Premiums and agents' balances in course of collection	2,811,591	232,908	2,578,683
Federal and foreign income tax recoverable and interest theron	3,163,338	1,592,387	1,570,951
Electronic data processing equipment and software	82,928	39,581	43,347
Interest, dividends, and real estate income due and accrued	1,204,447		1,204,447
Receivable from parent, subsidiaries, and affiliates	121,871		121,871
Other assets nonadmitted:			
Leasehold improvements	15,853	15,853	0
Write-ins for other than invested assets:			
Prepaid expenses	249,261	249,261	0
Receivable from leasing company	2,729	2,729	0
Miscellaneous assets	40,089	25,181	14,908
Total Assets	$80,865,851	$2,157,900	$78,707,951

Old Republic Surety Company
Liabilities, Surplus, and Other Funds
As of December 31, 2002

Losses		$ 8,252,817
Loss adjustment expenses		6,753,188
Commissions payable, contingent commissions, and other similar charges		715,000
Other expenses (excluding taxes, licenses, and fees)		5,008,529
Taxes, licenses, and fees (excluding federal and foreign income taxes)		621,588
Federal and foreign income taxes		188,275
Unearned premiums		21,805,391
Advance premium		278,597
Ceded reinsurance premiums payable (net of ceding commissions)		378,924
Amounts withheld or retained by company for account of others		260,192
Drafts outstanding		739,310
Write-ins for liabilities:		
Miscellaneous liabilities		126,771
Total Liabilities		45,128,582
Common capital stock	$ 1,000,000	
Preferred capital stock	4,000,000	
Gross paid in and contributed surplus	16,534,036	
Unassigned funds (surplus)	14,145,333	
Less treasury stock, at cost:		
Preferred	2,100,000	
Surplus as Regards Policyholders		33,579,369
Total Liabilities and Surplus		$78,707,951

Old Republic Surety Company
Summary of Operations
For the Year 2002

Underwriting Income		
Premiums earned		$31,311,701
Deductions:		
Losses incurred	$3,078,153	
Loss expenses incurred	1,527,770	
Other underwriting expenses incurred	23,451,662	
Total underwriting deductions		28,057,585
Net underwriting gain or (loss)		3,254,116
Investment Income		
Net investment income earned	4,233,656	
Net realized capital gains or (losses)	75,670	
Net investment gain or (loss)		4,309,326
Other Income		
Net gain or (loss) from agents' or premium balances charged off	(287)	
Write-ins for miscellaneous income:		
Miscellaneous income	1,072	
Total other income		785
Net income (loss) before dividends to policyholders and before federal and foreign income taxes		7,564,227
Dividends to policyholders		159,478
Net income (loss) after dividends to policyholders but before federal and foreign income taxes		7,404,749
Federal and foreign income taxes incurred		2,456,675
Net Income		$ 4,948,074

Old Republic Surety Company
Cash Flow
For the Year 2002

Premiums collected net of reinsurance			$31,919,518
Deduct:			
Loss and loss adjustment expenses paid (net of salvage or subrogation)			5,112,094
Underwriting expenses paid			23,195,506
Other underwriting (income) expenses			(211,652)
Cash from underwriting			3,823,570
Net investment income			4,312,918
Other income (expenses):			
Agents' balances charged off		($287)	
Net amount withheld or retained for account of others		65,296	
Write-ins for miscellaneous items:			
Miscellaneous income		1,072	
Total other income			66,081
Deduct:			
Dividends to policyholders paid			159,478
Federal income taxes paid (recovered)			2,556,322
Net cash from operations			5,486,769
Proceeds from investments sold, matured, or repaid:			
Bonds	$10,251,098		
Stocks	453,649		
Total investment proceeds		10,704,747	
Cost of investments acquired (long-term only):			
Bonds	9,412,748		
Stocks	2,470,682		
Total investments acquired		11,883,430	
Net cash from investments			(1,178,683)
Cash provided from financing and miscellaneous sources:			
Other cash provided	29,099		
Total		29,099	
Cash applied for financing and miscellaneous uses:			
Dividends to stockholders paid	3,000,000		
Net transfers to affiliates	47,539		
Total		3,047,539	

Net cash from financing and miscellaneous sources	(3,018,440)

Reconciliation

Net change in cash and short-term investments	1,289,646
Cash and short-term investments, December 31, 2001	1,840,389
Cash and short-term investments, December 31, 2002	$3,130,035

Old Republic Surety Company
Compulsory and Security Surplus Calculation
December 31, 2002

Assets		$78,707,951
Less liabilities		45,128,582
Adjusted surplus		33,579,369
Annual premium:		
Lines other than accident and health	$31,796,643	
Factor	20%	
Compulsory surplus (subject to a minimum of $2 million)		6,359,329
Compulsory surplus excess (or deficit)		$27,220,040
Adjusted surplus (from above)		$33,579,369
Security surplus: (140% of compulsory surplus, factor reduced 1% for each $33 million in premium written in excess of $10 million, with a minimum factor of 110%)		8,903,061
Security surplus excess (or deficit)		$24,676,308

Old Republic Surety Company
Reconciliation and Analysis of Surplus
For the Five-Year Period Ending December 31, 2002

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	2002	2001	2000	1999	1998
Surplus, beginning of year	$32,422,719	$28,842,976	$25,839,745	$22,398,817	$20,177,955
Net income	4,948,074	4,396,304	5,181,867	5,199,421	4,369,186
Net unrealized capital gains or (losses)	(558,991)	471,712	(240,872)	(33,666)	(22,554)
Change in net deferred income tax	(117,203)	28,404			
Change in non-admitted assets	(115,230)	(155,487)	62,236	125,173	(72,823)
Cumulative effect of changes in accounting principles		1,339,645			
Dividends to stockholders	(3,000,000)	(2,395,000)	(2,000,000)	(1,850,000)	(1,850,000)
Note receivable – Life insurance proceeds		(105,835)			
Extraordinary amounts of taxes for prior years					(202,947)
Surplus, end of year	$33,579,369	$32,422,719	$28,842,976	$25,839,745	$22,398,817

Old Republic Surety Company
Insurance Regulatory Information System
For the Five-Year Period Ending December 31, 2002

The company's NAIC Insurance Regulatory Information System (IRIS) results for the period under examination are summarized below. There were no unusual results.

	Ratio	2002	2001	2000	1999	1998
#1	Gross Premium to Surplus	100.0%	98.0%	105.0%	117.0%	138.0%
#2	Net Premium to Surplus	95.0	94.0	100.0	112.0	132.0
#3	Change in Net Writings	5.0	5.0	0.0	(2.0)	(4.0)
#4	Surplus Aid to Surplus	0.0	0.0	0.0	0.0	0.0
#5	Two-Year Overall Operating Ratio	75.0	75.0	77.0	79.0	77.0
#6	Investment Yield	5.9	6.3	6.4	6.3	6.4
#7	Change in Surplus	3.0	10.0	6.0	9.0	7.0
#8	Liabilities to Liquid Assets	61.0	62.0	64.0	66.0	70.0
#9	Agents' Balances to Surplus	8.0	8.0	8.0	8.0	10.0
#10	One-Year Reserve Devel. to Surplus	(11.0)	(12.0)	(16.0)	(11.0)	(13.0)
#11	Two-Year Reserve Devel. to Surplus	(17.0)	(23.0)	(21.0)	(18.0)	(24.0)
#12	Estimated Current Reserve Def. To Surplus	(7.0)	(12.0)	(14.0)	(10.0)	(15.0)

Growth of Old Republic Surety Company

Year	Admitted Assets	Liabilities	Surplus As Regards Policyholders	Net Income
2002	$78,707,951	$45,128,582	$33,579,369	$4,948,074
2001	77,177,267	44,754,548	32,422,719	4,396,304
2000	73,689,222	44,846,246	28,842,976	5,181,867
1999	70,424,076	44,584,331	25,839,745	5,199,421
1998	68,358,720	45,959,903	22,398,817	4,369,186
1997	66,492,328	46,314,373	20,177,955	4,672,586

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss And LAE Ratio	Expense Ratio	Combined Ratio
2002	$33,417,396	$31,956,121	$31,311,701	14.7%	74.9%	89.6%
2001	31,758,300	30,388,769	29,557,857	14.8	77.2	92.0
2000	30,163,084	28,902,243	29,696,224	15.1	73.2	88.3
1999	30,275,238	29,019,905	30,177,830	16.0	72.6	88.6
1998	30,861,213	29,621,584	30,031,993	18.3	73.5	91.8
1997	31,974,770	30,752,488	30,061,838	17.1	71.6	88.7

Since its inception, the company has been consistently profitable. The company has not incurred a net loss since 1996 and has reported average net income of over $4.8 million during the five-year period under examination. Net income can be attributable to the combination of steady investment income from its portfolio that is primarily composed of fixed income investments as well as its strict underwriting standards. The profitability of the company is reflected in the company's loss and LAE ratio averaging 15.8% and its combined ratio being at or below 92% for the past five years. Profitability has also aided in the company's surplus to increase by over $13.4 million (66%) since the prior examination.

Since 1997, gross premiums written have increased by 8.3%. As mentioned earlier in the report, the company has a very methodical marketing strategy to increase business writings. This combined with strict underwriting standards has caused written premiums to increase gradually. The company does not rely heavily on reinsurance, which is reflected in the small difference between gross premium written and net premium written. Limited selective growth has aided the company's financial performance in its niche market, while some of its larger competitors have incurred large losses due to their aggressive growth strategies.

Reconciliation of Surplus per Examination

No adjustments were made to surplus as a result of the examination.

Examination Reclassifications

	Debit	Credit
Amounts withheld or retained by company for account of others	$ 231,355	
Aggregate write-ins for liabilities		$119,351
Commissions payable, contingent commissions and other similar charges		112,004
Total reclassifications	$ 231,355	$231,355

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were 10 specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Bylaws—It is recommended that the company amend its bylaws as necessary to reflect practices of corporate governance accurately and to remain in accord with statutory requirements.

   Action—Compliance

2. Affiliated Agreements—It is recommended that future agreements with affiliates be reported to Wisconsin's Commissioner of Insurance as required by applicable statutes and rules of the Commissioner of Insurance.

   Action—Compliance

3. Cash—It is recommended that the company establish a procedure for the periodic reconciliation of all bank accounts, and for reporting the proper valuation of all bank accounts on future statutory financial statements.

   Action—Compliance

4. Cash—It is recommended that the company classify money market mutual funds in accordance with the NAIC's Annual Statement Instructions-Property and Casualty, pursuant to s. Ins 50.20 (1) (b), Wis. Adm. Code.

   Action—Compliance

5. Short-term Investments—It is recommended that the company take corrective action to ensure that interest income figures are properly reported on future statutory financial statements.

   Action—Compliance

6. Premium and Agents' Balances in Course of Collection—It is recommended that the company either settle the "Direct Bill Cash Differences" item, or if the item is not reconcilable, write the outstanding balance into income.

   Action—Compliance

7. Losses and Loss Adjustment Expenses—It is recommended that future actuarial reports include a comparison of reserves indicated by actuarial analysis and those carried by the company on a net and direct basis with references to supporting work papers and exhibits. It is further recommended that future actuarial reports comment upon material variances between carried reserves and the results supplied by actuarial analysis each category of business reviewed.

   Action—Compliance

8. <u>Losses and Loss Adjustment Expenses</u>—It is recommended that future actuarial opinions or supporting work papers include comment on the materiality of the nonreviewed exposures or otherwise explain the rationale for declining to review selected lines of business.

   <u>Action</u>—Compliance

9. <u>Losses and Loss Adjustment Expenses</u>—It is recommended that the company notify OCI should the company be exposed to loss on any environmental reclamation bond in a period for which no premium has been paid.

   <u>Action</u>—Compliance

10. <u>Losses and Loss Adjustment Expenses</u>—It is recommended that the company maintain a correct presentation of Schedule P with respect to unallocated loss adjustment expense reserve payments.

    <u>Action</u>—Compliance

Summary of Current Examination Results

EDP Equipment

As part of the examination of the company's electronic data processing equipment, the examiners reviewed SSAP 16, paragraph 5 & 6, which states that the following disclosures shall be made in the annual audited statutory financial reports only:

a. Depreciation and amortization expense for the period;
b. For EDP equipment and operating system software, balances of major classes of depreciable assets, by nature or function, at the balance sheet date;
c. For EDP equipment and operating system software, accumulated depreciation and amortization, either by major classes of depreciable assets or in total, at the balance sheet date; and
d. A general description of the method or methods used in computing depreciation with respect to major classes of depreciable assets.

In reviewing the company's audited statutory financial report, the examiners could not locate these disclosures. It is recommended that the company comply with the required EDP disclosures in future annual audited statutory financial reports in accordance with SSAP No. 16, paragraph 5 and 6.

Amounts Withheld or Retained for Account of Others $28,837

The original liability of $260,192 represents employee payroll deductions in the possession of the company at December 31, 2002. Review of this balance revealed that an escheat fund liability in the amount of $231,355 was included in the detail of this account. According to the NAIC Annual Statement Instructions – Property & Casualty, uncashed drafts and checks that are pending escheatment to a state should be listed separately under Aggregate Write-ins for Liabilities. It is recommended that the company properly record its escheat fund liability in future annual audited statutory financial reports in accordance with the NAIC Annual Statement Instructions – Property & Casualty. A reclassification has been made in the "Reconciliation of Surplus Per Examination" section of this report to reflect the above finding.

Aggregate Write-Ins for Liabilities $14,767

The original liability of $126,771 represents liability balances that do not fall under the standard balance sheet liability definitions. Review of this balance revealed that the company had a direct bill commissions payable liability of $112,004, which was included in the detail of this account. According to the NAIC Annual Statement Instructions – Property & Casualty, direct bill commissions payable liabilities should be included in the commission payable, contingent commissions and other similar charges line. It is recommended that the company properly record the direct bill commissions payable balance in future Annual Statement filings in accordance with the NAIC Annual Statement Instructions – Property & Casualty. A reclassification has been made in the "Reconciliation of Surplus Per Examination" section of this report to reflect the above finding.

VIII. CONCLUSION

Policyholders' surplus has increased from $20,177,955 as of year-end 1997, to $33,579,369 as of year-end 2002. This represents an increase of 66.4% during the period under examination, despite paying over $11 million of shareholder dividends during this time.

The examination of Old Republic Surety Company resulted in three recommendations none of which were repeat recommendations, no adjustment to surplus and two reclassifications. The first reclassification and its corresponding recommendation was due to the company inappropriately reporting the direct billed commissions payable balance on the Annual Statement as a write-in liability. The other reclassification and its corresponding recommendation were due to the company inappropriately reporting escheatable funds in the Annual Statement. The last recommendation that was made related to a statutory reporting requirement for electronic data processing equipment.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 38 - EDP Equipment—It is recommended that the company comply with the required EDP disclosures in future annual audited statutory financial reports in accordance with SSAP No. 16, paragraph 5 and 6.

2. Page 38 - Amounts Withheld or Retained for the Account of Others—It is recommended that the company properly record its escheat fund liability in future annual audited statutory financial reports in accordance with the NAIC Annual Statement Instructions – Property & Casualty.

3. Page 39 - Aggregate Write-Ins for Liabilities—It is recommended that the company properly record the direct bill commissions payable balance in future Annual Statement filings in accordance with the NAIC Annual Statement Instructions – Property & Casualty.

X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance (OCI), State of Wisconsin, participated in the examination:

Name	Title
Jerry C. DeArmond	Insurance Financial Examiner Advanced Loss Reserve Specialist
Cruz J. Flores	Insurance Financial Examiner Advanced Data Processing Audit Specialist
Tom M. Janke	Insurance Financial Examiner
Russel L. Lamb	Insurance Financial Examiner
Frederick H. Thornton	Insurance Financial Examiner Advanced Exam Planning & Quality Control Specialist
Sheur Yang	Insurance Financial Examiner

Respectfully submitted,

John E. Litweiler
Examiner-in-Charge